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FISCAL IMPACT STATEMENT

LS 6903 **NOTE PREPARED:** Jan 13, 2006
BILL NUMBER: HB 1333 **BILL AMENDED:**

SUBJECT: Educational Scholarship Programs.

FIRST AUTHOR: Rep. Messer **BILL STATUS:** As Introduced
FIRST SPONSOR:

FUNDS AFFECTED: X **GENERAL**
X **DEDICATED**
FEDERAL

IMPACT: State

Summary of Legislation: The bill establishes: (1) a scholarship tax credit for charitable contributions made to an organization that grants scholarships to pay the tuition and fees that a student would otherwise be obligated to pay to attend a public or private school; and (2) a School Readiness Scholarship Program to pay the tuition and costs that a child determined to be at risk by the Division of Family Resources would otherwise be obligated to pay to enroll in a preschool operated by a public or nonpublic school. The bill also designates up to $35,000,000 of federal money available from the federal Temporary Assistance for Needy Families Program (TANF) to be used for School Readiness Scholarships.

Effective Date: Upon passage; July 1, 2005 (retroactive); January 1, 2006 (retroactive).

Explanation of State Expenditures: ***Great Schools Scholarship Programs:*** The bill establishes the Great Schools Scholarship Program to be administered by the Department of Education (DOE) beginning in FY 2007. The bill provides that DOE certify and enter into agreements with tax-exempt educational scholarship organizations that meet certain other criteria to be Great Schools Scholarship Programs. Under the bill, contributions to the scholarship programs by individual and corporate taxpayers, including pass through entities, would qualify for a tax credit (see *Explanation of State Revenues*). For an organization to qualify as a Great Schools Scholarship Program, it must:

(1) be exempt from federal income taxation under Section 501(c)(3) of the Internal Revenue Code;
(2) be organized at least in part to grant educational scholarships;
(3) apply to the DOE for certification in the prescribed manner;
(4) enter into an agreement with the DOE to comply with the provisions of the bill and rules adopted by the

DOE;
(5) demonstrate financial viability of the organization by filing either a surety bond payable to the state or financial information demonstrating financial viability.

The agreement with the DOE described in (4) above must provide for the organization to meet additional requirements including that the organization: (1) distribute at least 90% of its contributions as scholarships to "eligible students"; (2) distribute 100% of any income earned on contributions as scholarships to eligible students; (3) distribute part of the scholarships each year to eligible students in the county where the organization expends the majority of its scholarship; and (4) distribute part of the scholarships each year to first-time recipients who were enrolled in the school corporation where the eligible students had legal settlement during the prior year.

The bill defines an "eligible student" as an individual who: (1) has legal settlement in Indiana; (2) is at least 5 years old but less than 22 years old; and (3) either (a) is a member of a household with an annual income less than 250% of the income amount required for the child to qualify for the federal Free or Reduced Price Lunch Program; or (b) received a scholarship under the Great Schools Scholarship Program during the prior school year. For the 2005-2006 school year, the reduced price lunch income threshold for a child from: (1) a two-member household is $23,736; (2) a three-member household is $29,767; and (3) a four-member household is $35,798. (*Note:* The reduced price lunch threshold is higher than the free lunch threshold.) Thresholds equal to 250% of these amounts, respectively, are: (1) $59,340; (2) $74,418; and (3) $89,495.

Department of Education (DOE): The DOE would be required to administer an application, review, and certification process for tuition-granting organizations to obtain status as a Great Schools Scholarship Program. The DOE also would have to perform oversight tasks to ensure that certified organizations are adhering to the requirements of the Program. It is unknown how many organizations might seek certification by the DOE, but the DOE should be able to implement these tasks given its current level of resources. According to the January 9, 2006, state staffing table, the DOE has 83 vacant, full-time positions.

Department of State Revenue (DOR): The DOR would incur some administrative expenses relating to the revision of tax forms, instructions, and computer programs to incorporate the Great Schools Scholarship Program tax credit. The DOR's current level of resources should be sufficient to implement this change.

Public School Funding: The movement of students from public schools to nonpublic schools due to tuition scholarships could result in a saving to the state which would partially offset the cost of the tax credit. The amount per student that could potentially be saved in this circumstance is indeterminable beyond 2007, as a school funding formula for 2008 and after has not been established. Under the current funding scheme, the CY 2007 per pupil funding amount will be about $5,362. However, the state would accrue savings from students who move from a declining enrollment school district to a nonpublic school of only a portion of the per pupil amount until the student has been enrolled in the nonpublic school for five consecutive years. Under the current funding scheme, the savings to the state would be: (1) 20% of the per pupil amount the first year the student attends the nonpublic school; (2) 40% of the per pupil amount the second year; (3) 60% of the per pupil amount the third year; (4) 80% of the per pupil amount the fourth year; and (5) 100% of the per pupil amount beginning in the fifth year.

Movement of students from one public school to another public school, would not generate state savings and not offset revenue loss from the credit.

Annual scholarship totals funded under a similar program in Arizona (the Arizona Tuition Organization Tax Credit Program) are reported in the table below. The tax credit was enacted in 1997. The 1998 totals were reportedly abnormally low due to a court challenge of the tax credit which was ultimately resolved in January 1999 by the Arizona Supreme Court.

Year	AZ Scholarships Funded from Contributions
1998	244
1999	3,713
2000	15,377
2001	18,100
2002	19,568
2003	20,138
2004	21,160

Smart Start Schools Readiness Scholarship Program: The bill requires the Division of Family Resources (DFR) to establish the Smart School Readiness Scholarship Program (Program). The Program would provide scholarships for at-risk youth to attend preschool. Expenditures for the program would be dependent on administrative action.

The bill allows the DFR, after consulting with the DOE, to adopt rules. The DFR should be able to do so within its existing level of resources. If adopted, rules must: qualify expenditures for the Program for reimbursement under the Temporary Assistance for Needy Families (TANF) program; specify criteria for determining the eligibility of at-risk preschool children, including eligibility guidelines; specify criteria for both public and nonpublic preschool programs; and specify a method for payment to eligible preschool programs.

Under the bill, children ages 3, 4, and 5 would be eligible for a scholarship through the Program. There are approximately 90,000 children per age group in Indiana, placing the total age-eligible children at 270,000. The bill, however, requires that eligible children be at risk, and that program expenditures be reimbursable under TANF. The gross family income attributable to a child under TANF rules and guidelines must be less than 250% of the federal poverty level (FPL). The Annie E. Casey Foundation reports that in FFY 2003, 38% of children in Indiana lived with families with incomes at or below 200% of the FPL. Using the Foundation's percentage, a total of 102,600 children would be eligible for scholarships under the Program; however, this number is likely low. The number of children living with families with income levels between 200% and 250% of the FPL is not known.

Note: Actual numbers of children applying for the program could be reduced. A portion of eligible children would already receive preschool funding through the Child Care and Development Fund (CCDF) voucher program or the Head Start program.

Potential Funding: The bill allows the Budget Agency to designate not more than $35 M from the TANF program for the purposes of distributing scholarships for the Program. The bill requires the DFR to seek approval of an amendment of the state TANF plan if one is needed to use federal funds for the Program.

Background Information on Use of TANF Dollars: The DFR reports that the state is able to transfer dollars from the TANF program to other state programs as long as the program that the funds are transferred to addresses one of the four TANF goals. These include: (1) providing assistance to needy families with children; (2) ending the dependence of the need for assistance, for example, through job preparation; (3) reducing the number of out-of-wedlock births; and (4) maintaining two-parent families. There is no cap on the amount of dollars that can be transferred to programs (with the exception of CCDF and SSBG). Examples of other programs that currently receive TANF dollars are Healthy Families ($32 M) and First Steps ($13 M). It should be noted that all TANF funds are currently earmarked. Thus, transfer of TANF dollars to the Program would result in a reduction in TANF funding for another program. The state is required to provide an annual maintenance of effort (MOE) of approximately $121 M for TANF dollars. The MOE is, however, currently being met; thus, no additional state funding would be required.

Explanation of State Revenues: ***Great Schools Scholarship Program Tax Credit:*** The tax credit would reduce tax liabilities of individual and corporate taxpayers who make contributions to school tuition organizations that conduct Great Schools Scholarship Programs certified by the DOE (see *Explanation of State Expenditures*). The tax credit is applicable to the Adjusted Gross Income (AGI) Tax, the Financial Institutions Tax, and the Insurance Premiums Tax. The potential fiscal impact from individual taxpayers is presented in the table below. The credit totals could potentially be higher than these estimates to the extent that corporate taxpayers also respond to this credit. The amount by which corporate tax credits could potentially increase the revenue loss is indeterminable.

Fiscal Year	Credit Amount
2007	$8.5 M
2008	$10.9 M
2009	$15.4 M
2010	$16.1 M
2011	$18.1 M
2012	$19.6 M

Background: The nonrefundable tax credit is equal to 50% of the amount contributed to a tuition organization conducting a Great Schools Scholarship Program certified by the DOE. Unused tax credits may be carried over to subsequent taxable years by the taxpayer. The tax credit is not refundable, and taxpayers may not carry back unused tax credits. The criteria for a Great Schools Scholarship Program are outlined above under *Explanation of State Expenditures*. Since the credit is effective beginning in tax year 2006, the fiscal impact would likely begin in FY 2007. Revenue from the corporate AGI Tax, the Financial Institutions Tax, and the Insurance Premiums Tax is distributed to the state General Fund. Eighty-six percent of the revenue from the AGI Tax on individuals is deposited in the state General Fund, and 14% of the revenue is deposited in the Property Tax Replacement Fund.

A tuition organization contribution tax credit was enacted in Arizona in 1997. Estimates of annual credit totals specified in the table above are imputed based on annual credit totals claimed by Arizona taxpayers from 1999 to 2004. These estimates likely provide a minimum revenue loss estimate assuming similar response as in Arizona. The reasons for this are as follows. The Arizona credit is only available to individual taxpayers and is capped at $500. The average donation in Arizona is about $500, with the cap likely holding the average down. So, to the extent that individual taxpayers in Indiana contribute more than $1,000 to a tuition organization, the revenue loss could be higher than the estimates. In addition, creditable contributions by corporate taxpayers would provide for additional indeterminable revenue loss amounts.

The imputed totals for individual taxpayers are derived with adjustment for population differences between the two states based on Census 2000 results. Thus, the number of individual taxpayers making contributions to tuition organizations are estimated to be about 20% higher than in Arizona, provided taxpayer response rates are similar. The 1998 totals are not utilized for these estimates since they were reportedly abnormally low due to a court challenge of the tax credit that was ongoing during 1998. This challenge was ultimately resolved in January 1999 when the Arizona Supreme Court upheld the tax credit law. Subsequently, the U.S. Supreme Court refused to hear a challenge to the tax credit law. Credits claimed in 1998 totaled only $1.8 M.

Explanation of Local Expenditures:

Explanation of Local Revenues:

State Agencies Affected: Department of State Revenue; Department of Education; Division of Family Resources.

Local Agencies Affected:

Information Sources: *Child Nutrition Programs - Income Eligibility Guidelines*, Federal Register, Vol. 70, No. 52, Friday, March 18, 2005. Georganna Meyer, Arizona Department of Revenue, (602) 716-6927. Arizona Department of Revenue, *Individual Income Tax Credit for Donations to Private School Tuition Organizations: Reporting for 2004;* 2005 *Kids Count Data Book.*

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